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TO RUEHC/SECSTATE WASHDC 6108  
RUEATRS/DEPT OF TREASURY WASHDC  
INFO RUCPDOG/USDOC WASHDC  
RUEHBK/AMEMBASSY BANGKOK 3770  
RUEHBJ/AMEMBASSY BEIJING 7048  
RUEHUL/AMEMBASSY SEOUL 8781  
RUEHGP/AMEMBASSY SINGAPORE 6948  
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RUEHML/AMEMBASSY MANILA 0106  
RUEHJA/AMEMBASSY JAKARTA 4104  
RUEHKL/AMEMBASSY KUALA LUMPUR 3784  
RUEHHI/AMEMBASSY HANOI 3353  
RUEHBY/AMEMBASSY CANBERRA 4563  
RUEHWL/AMEMBASSY WELLINGTON 1832  
RUEHHK/AMCONSUL HONG KONG 8293  
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UNCLAS SECTION 01 OF 03 TAIPEI 001653

SIPDIS

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STATE FOR EAP/RSP/TC, EAP/EP  
USTR FOR ALTBACH and Stratford  
USDOC FOR 3132/USFCS/OIO/EAP/WZARIT  
TREASURY FOR OASIA/TTYANG  
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF  
GOVERNORS, AND SAN FRANCISCO FRB/TERESA CURRAN AND NY FRB MARIA  
BOLIS

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SUBJECT: Individual Debt Resolution Law

SUMMARY

¶1. In June, Taiwan completed legislation of the Individual Debt Resolution Law (IDRL), which will be effective in early 2008. The law, designed to address non-performing unsecured loans only, will permit insolvent individual debtors to repay a portion of outstanding debt over a length of time longer than the repayment period stated in the original loan contracts. At the insistence of the banking sector, individuals already reaching rescheduling agreements with banks will be exempt from the law. Observers worry the law will erode the banking sector's profitability and lead banks to make fewer unsecured loans. END SUMMARY.

Legislation Procedure

¶2. In June, the Legislative Yuan (LY) completed the third and final reading of the IDRL. The new law will become effective nine months after the President promulgates it, in March 2008.

Debt Resolution

¶3. The IDRL is designed to address non-performing unsecured loans only. There are two ways of debt resolution, i.e., debtor rehabilitation and debt liquidation. During the debtor rehabilitation period, creditors may not exercise their rights against the debtors, including lawsuits. Debt liquidation is a de facto bankruptcy procedure for individuals. The new law will only allow eligible individual debtors to apply to the court for debt resolution, while creditors, including banks, may not.

Eligibility

14. The law will apply to insolvent individual debtors who have not engaged in business activities over the past five years. It will also apply to insolvent debtors who over the past five years have engaged in small business with average monthly sales of less than NT\$200,000 (US\$6,060). Individuals who have already reached rescheduling agreements with banks will be exempt from the individual debtor resolution mechanism.

#### Debtor Rehabilitation

##### Additional Eligibility Requirement

15. In order to be eligible for debtor rehabilitation, a debtor's total unsecured liabilities must be under NT\$12 million (US\$364,000).

##### Rescheduling Negotiation

16. Insolvent debtors will be required to engage in rescheduling negotiations with creditor banks before application for rehabilitation. The court may grant its permit for debtor rehabilitation 30 days after a creditor bank does not respond to the debtor's negotiation request or 90 days after the negotiations fail to conclude with a rescheduling agreement.

##### Payment Rescheduling

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17. For rehabilitation, debtors are required to reschedule their repayment plans and submit them to the court for approval. The law will allow debtors to repay only 20% of their debt in three-month installments over six-to-eight years.

#### Liquidation

18. The court may adopt a liquidation program for a delinquent debtor if the debtor is unable to repay (defined as a person whose income minus living expenses is less than 20% of the person's outstanding debt), fails to come up with a rescheduling plan within a specified period under rehabilitation, or fails to fulfill his commitments as stated in the rescheduling agreement.

##### Strict Restrictions on Daily Living

19. The court will set restrictions on debtors' daily living expenses during rehabilitation. Debtors going through liquidation will lose freedom of movement, and may not go beyond a restricted area set by the court. They are subject to strict restrictions on employment, disposal of property, and spending. They may not serve as lawyers, certified public accountants, architects, auditors, etc. They may not run for any public office, and will be subject to a variety of restrictions on personal expenditure. Offenders will be sent to jail and debt reinstalled.

#### Discharge

110. Debtors will be discharged of their liability obligation after they fulfill their rescheduling commitments under rehabilitation, or after they complete the liquidation procedure. Debtors may apply to the court for resumption of their normal lives and civil rights five years after the discharge of liability.

##### Concerns, Likely Consequences

111. Local and foreign bankers are concerned that the IDRL will substantially increase their unsecured loan lending risks because

the law permits discharge of liability six-to-eight years after the interest rate is lowered, and the repayment terms are discounted and extended. To reduce the risks, banks will tighten lending, thereby perhaps making unsecured loans more difficult to obtain. Bankers Association (BA) Chairman Hsu Te-nan warned that many individuals will be forced to turn to loan sharks and underground banking organizations. Merrill Lynch (Taiwan) estimated that moral hazard will erode ten percent of the banking community's combined profits next year.

¶12. The Banking Sector Consumers' Interest Protection Association (CIPA), a debtors' organization headed by Legislator Shyu Jong-shyong (KMT), described the IDRL legislation as "belated incomplete justice." The debtors' organization is happy that the IDRL will help delinquent debtors resolve their debt problems. The CIPA, however, is still upset about the deletion of a home mortgage article that would have allowed debtors to pay discounted interest for up to ten years before beginning repayment.

¶13. A Banking Bureau contact told us that the IDRL will affect Taiwan more socially than economically. According to the contact, an estimated 50,000 individual debtors may seek debt resolution from the court after the IDRL becomes effective in March 2008, but the number will be much smaller than the over 250,000 delinquent credit/cash card debtors that negotiated with banks in 2006.

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Comment

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¶14. The IDRL will affect Taiwan's banking sector, but is unlikely to cause a banking crisis, as unsecured loans account for only 5-6% of the sector's total outstanding loans, and Taiwan's average non-performing loan (NPL) ratio is below 2.5%. To some extent, debt resolution will erode the banking sector's profitability due to failure to follow the prudential principle in lending.

YOUNG